e
d
r
-
e
f
s
f
h
l
-
r
s
v
a
l
s
4
v
3
t

10

No. 28, 29

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

CLAUDGE APARTMENTS COMPANY, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

On Writ of Certiorari to the Circuit Court of Appeals for the Seventh Circuit.

BRIEF OF AMICUS CURIAE.

H. BRYAN HOLLAND,
Amicus Curiae.

HOMER HENDRICKS,
Of Counsel.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

INDEX.

CITATIONS.

CASES:

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

No. 28, 29.

CLARIDGE APARTMENTS COMPANY, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

On Writ of Certiorari to the Circuit Court of Appeals for the Seventh Circuit.

PETITION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE.

The undersigned respectfully petitions this Honorable Court for leave to file the accompanying brief in this case as *amicus curiae*. The Solicitor General and counsel for the taxpayer have assented in writing; as indicated by letters filed with the clerk of this Court.

Respectfully submitted,

H. BRIAN HOLLAND.

October, 1944.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

No. 28, 29.

CLARIDGE APARTMENTS COMPANY, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

On Writ of Certiorari to the Circuit Court of Appeals for the Seventh Circuit.

BRIEF OF AMICUS CURIAE.

Scope of Brief.

This brief is directed solely to the question whether indebtedness of a corporation is "canceled or reduced", within the meaning of Section 270 of the Bankruptcy Act (*infra*, p. 15), when, in a reorganization proceeding under Section 77B or Chapter X of that Act, stock having a fair market value lower than the face amount of the corporation's bonds is issued in exchange for those bonds. We submit that this question should be answered in the negative.

Ambiguity of the Statute.

The question is manifestly one of statutory interpretation, requiring a determination of what Congress meant by the words "canceled or reduced". The court below thought it sufficient to say that those words should be taken in their broadest and most literal sense. It said:

> "The words 'canceled or reduced', as used in this statute, are comprehensive. Given their ordinary or literal meaning, they cover a case such as is here presented. Here there was an elimination of the bonded indebtedness."

And, again

> " * * * In the instant case the debt was entirely eliminated. In place thereof, stock of much less market value than the face value of the debt was issued."

Clearly there can be no quarrel with the view that the substitution of stock in place of the outstanding bonds "entirely eliminated" the indebtedness which the bonds represented. However, to regard "canceled" as being synonymous with "entirely eliminated" would lead to results which Congress obviously cannot have intended. The "literal" interpretation advanced by the court below proves too much. Thus, indebtedness may be eliminated by full payment, on the one hand, or by forgiveness, on the other. By payment and forgiveness alike the debt is extinguished, canceled and reduced to zero. Yet it is doubtful whether anyone would seriously contend that Section 270 was applicable with respect to a cancelation of indebtedness by satisfaction in full.

Similarly, indebtedness may be said to be "reduced" by partial payment or forgiveness. If the debts of a company prior to reorganization total $50,000 and after the reorganization they are only $25,000, the indebtedness has been "reduced" by $25,000. But that reduction may have been effected by payment of $25,000 in cash and issuance of bonds or notes for the balance, or by the "gratuitous" cancelation of the debts to the extent of $25,000. If $25,000

were paid in cash and $25,000 in notes, Section 270 would, we submit, clearly require no reduction of basis. On the other hand, if $25,000 were canceled without consideration, a basis reduction of $25,000 would presumably be in order. Yet the indebtedness of the company would literally have been "reduced" by $25,000 in both cases.

It seems obvious, therefore, that Section 270 cannot be invoked by a mere showing that the debtor company's indebtedness has been "entirely eliminated" or is smaller after the reorganization than it was before. Congress evidently did not use the words "canceled or reduced" in that broad, literal sense. What, then, did Congress intend? The answer to that question can be determined only by examining Section 270 in the light of the circumstances which led to its enactment, and by viewing it against the background of the income tax laws of which—notwithstanding its incorporation in the Bankruptcy Act—it is essentially a part. *Helvering* v. *Morgan's, Inc.*, 293 U. S. 121, 126; *Helvering* v. *Stockholms Enskilda Bank*, 293 U. S. 84, 93-94.

Legislative History.

Sections 268 and 270 owe their existence to the decision of this Court in *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, holding that taxable income resulted from the purchase by a corporation of its bonds for less than the price at which they had been issued. That decision, handed down in 1931, was followed by a long line of cases in which debt reduction, effected under varying circumstances, was held to give rise to income subject to taxation.

When the Chandler Act was under consideration, it was feared by its proponents that application of the principle of the *Kirby Lumber Co.* case might materially interfere with the readjustments which that Act was designed to facilitate and encourage. Accordingly, there was included in the bill as reported by the House Judiciary Committee a provision designed to prevent the imposition of any income

tax upon gain or profit resulting from the "modification in or liquidation in whole or in part of" any indebtedness of the debtor in a plan consummated under the Act. (See H. Rep. No. 1409, 75th Cong., 1st Sess., pp. 55, 56, 111.) That provision, with certain changes in phraseology suggested by the Senate, was enacted as Section 268. (See S. Rep. No. 1916, 75th Cong., 3rd Sess., p. 7.)

The Treasury Department offered no objection to the substance of Section 268, but urged the adoption of a complementary provision requiring reduction of basis of the debtor's assets to compensate for the loss of revenue which would result from the enactment of that section, lest "what is originally intended to be a relief provision * * * turn out * * * to be an unwarranted grant of tax reduction." (See letter of Roswell Magill, Acting Secretary of the Treasury, January 14, 1938, printed in Hearings Before a Subcommittee of the Committee on the Judiciary, United States Senate, 75th Cong., 2d Sess., on H. R. 8046, at p. 144.) That provision, described as being "intended to avoid a double deduction", was written into the Act as Section 270. (See S. Rep. No. 1916, *supra*, at pp. 7, 39.)

This brief sketch of the legislative history of Sections 268 and 270 suffices, we believe, to make it clear that they were intended as relief provisions; that Section 270 was intended to complement Section 268; and that together the two sections were designed to defer the recognition of income or profit which would otherwise be taxable in the year in which the plan of reorganization became effective.

Application of Section 270 Limited by Section 268.

The considerations outlined above afford strong support for the argument that Section 270 should be interpreted as calling for a reduction of basis only if and to the extent that taxable income would have been realized upon the reorganization in the absence of the specific exemption conferred by Section 268. The materials in support of that interpretation are set forth in greater detail in the taxpayer's brief and need not be elaborated here. We believe

the interpretation to be sound and in accord with the actual intent of Congress. Moreover, it is a logical and sensible interpretation. It is understandable that Congress should have deemed it proper to exact a *quid pro quo*, in the form of a basis adjustment, for benefits conferred by Section 268, but it is difficult, indeed, to perceive any reason why Congress should have desired to impose the burden of a reduction in basis where no corresponding benefit was conferred by the companion section. And we submit that there is no necessity for concluding that Congress had any such intention once it is recognized that the words "canceled or reduced" cannot in any event be taken in their strictly literal sense.[14]

If the interpretation suggested above is the correct one, we submit there can be little doubt that Section 270 does not apply to indebtedness eliminated by means of a substitution of stock for bonds in a purely capital transaction. "In essence this is a capital transaction like an ordinary subscription for stock, involving realization of no gain or loss by the corporation." Darrell, *Discharge of Indebtedness and the Federal Income Tax*, 53 Harvard L. Rev. 977, 998. The Board of Tax Appeals (now the Tax Court) has consistently so held, usually in response to the contentions of the Commissioner to that effect. The question has arisen in two groups of cases. In the first, and earlier, group the Board, sustaining the Commissioner, held that a corporation might not deduct unamortized bond discount in a year in which the bonds were retired by the issuance of stock in exchange therefor. *Chicago, Rock Island & Pacific Railway Co.* v. *Commissioner*, 13 B. T. A. 988, affirmed, 47 F. (2d) 990 (C. C. A. 7th), cert. den., 284 U. S. 618; *375 Park Avenue Corp.* v. *Commissioner*, 23 B.

[14] It has been suggested that an interpretation which would permit "reduction of basis below cost without relation to the extent to which gain would otherwise be taxable" would raise a serious constitutional question. Warren and Sugarman, *Cancellation of Indebtedness and Its Tax Consequences*, 41 Col. L. Rev. 61, 77; Darrell, *Discharge of Indebtedness and the Federal Income Tax*, 53 Harv. L. Rev. 977, 1010.

T. A. 969 (Acq. X-2 C. B. 70); *Pierce Oil Corp.* v. *Commissioner*, 32 B. T. A. 403; *Liquid Carbonic Corp.* v. *Commissioner*, 34 B. T. A. 1191.[1] See, also, I. T. 2347, VI-1 C. B. 86; G. C. M. 9674, X-2 C. B. 754; T. D. 4603, XIV-2 C. B. 58. The theory of these decisions and rulings is summarized in the *Liquid Carbonic Corp.* case as follows (p. 1196):

> "The ground upon which these decided cases stand is that the conversion of bonds into capital stock of the obligor is purely a capital transaction; that is, a readjustment of the obligor's capital structure, which does not result in either a deductible loss or a taxable gain. The obligor does not pay out anything. It merely readjusts its capital. As we said in *375 Park Avenue Corporation, supra*, 'Instead of suffering the outlay of money in excess of the amount borrowed, it created a new distribution of its shares, thus avoiding its fixed financial obligation and devoting the borrowed money to the ordinary risks of its business'."

So far as we are aware, the Commissioner still follows the rule laid down by the above authorities, although it seems entirely inconsistent with his present contention that gain or loss may be realized by a corporation which retires its bonds by issuing stock therefor. See Mertens, *Law of Federal Income Taxation*, § 12.116.

The second group of cases includes, in chronological order, *Capento Securities Corp.* v. *Comissioner*, 47 B. T. A. 691, affirmed, 140 F. (2d) 382 (C. C. A. 1st); the instant case; and *Alcazar Hotel, Inc.* v. *Commissioner*, 1 T. C. 872, now pending on appeal to the Circuit Court of Appeals for the Sixth Circuit. Of these three cases, only the present case and the *Alcazar* case involved Section 270 of the Bankruptcy Act, but the decisions of the Tax Court in both of them were expressly based on the principles stated by the

[1] It may be noted that, although the first two of these cases antedated the change in the attitude of the courts towards retirement of debt at a discount (*United States* v. *Kirby Lumber Co., supra*) and towards the tax significance of dealings by a corporation in its own stock (*Commissioner* v. *S. A. Woods Machine Co.*, 57 F. (2d) 635 (C. C. A. 1st)), the last two were decided subsequent to those changes. See 34 B. T. A. at p. 1197.

Board in the *Capento* case. That case raised squarely the question whether a corporation realized taxable gain upon the issuance of stock in retirement of its bonds, the fair market value of the stock being less than the principal amount of the bonds. The Tax Court adhered to the view that this kind of transaction is essentially a capital transaction, and held that there was no "present realization of gain". The Circuit Court of Appeals stated its agreement with that conclusion, and added (p. 386) that in any event the question was " 'only a question of proper tax accounting' in which the decision of the Board is controlling on the courts, there being no provision of statute or regulation specifically requiring a contrary holding."

Two other opinions of individual Board members (i. e., not reviewed by the full Board) should be mentioned in the interest of completeness. Both cases involved the deductibility of bond interest accruing during the portion of a year prior to the retirement of the bonds with stock. In each case the Board member, apparently assuming—or in any event suggesting the possibility—that the obligor corporation might have realized a gain to the extent of the difference between the fair market value of the stock and the amount of the obligations for principal and interest on the bonds, said that recognition of gain, if any, was prevented by Section 112(b)(3) of the Revenue Act of 1934 relating to exchanges of securities in a reorganization. *Hummel-Ross Fibre Corp. v. Commissioner*, 40 B. T. A. 821, 823 (*Acq.* 1940-1 C. B. 3); *Shamrock Oil & Gas Co. v. Commissioner*, 42 B. T. A. 1016, 1018 (Acq. 1940-2 C. B. 6). These observations appear to have been unnecessary to the disposition of the cases in respect of which they were made. In any event, so far as the present question is concerned it makes no difference whether there is no realization of income or realized income is non-recognized, since in either case there is no need for the company to avail itself of the benefits of Section 268 of the Bankruptcy Act.

The very paucity of cases presenting the question whether a corporation can have taxable income when it issues stock

in retirement of bonds strongly suggests a negative answer. The *Capento Securities* case, *supra*, appears to have been the first case in which the Commissioner of Internal Revenue ever attempted to collect a tax upon a capital readjustment of that type, and the opinion of the Circuit Court of Appeals intimates that the attempt in that case was attributable to certain peculiar facts there present. It seems entirely reasonable to assume that the administrative authorities have, until recently, agreed with the position of the Board of Tax Appeals that there is no realization of income or loss upon a substitution of stock for bonds in a recapitalization or reorganization. We submit that, even if there is room for difference of opinion as to the correct theory, the question is one as to which the judgment of the Board (now the Tax Court) should be accepted as final in the absence of any controlling statute or regulation. Cf. *Dobson* v. *Commissioner*, 320 U. S. 489.

Section 270 Inapplicable Here Even if Construed Without Regard to Section 268.

Although we believe the interpretation of Section 270 suggested above to be sound and in accord with the actual legislative intent, it is not necessary, in order to establish the inapplicability of that section to the present case, to limit its application to debt readjustments that would have given rise to taxable income in the absence of Section 268. We submit that, quite apart from Section 268, the language of Section 270, if given its ordinary and natural meaning, cannot be construed as requiring a reduction of asset basis in the case of a substitution of stock for bonds in a reorganization.

We think it will be conceded that the words "the amount by which the indebtedness of the debtor * * * has been canceled or reduced" cannot be taken in their most literal sense as including that part of the indebtedness which is discharged by satisfaction, and that they must be construed as referring only to that part, if any, which is discharged

without consideration, or is "forgiven".[2] That being so, the question is whether, in this type of case, the indebtedness represented by the bonds is to be regarded as having been satisfied by the issuance of stock, or whether some part of it is to be regarded as having been forgiven—and, if so, how much.

The government's argument is, in substance, that the indebtedness is satisfied to the extent of the fair market value of the stock, and that the balance is forgiven and thus represents the amount by which the indebtedness is canceled or reduced within the meaning of Section 270. We submit, however, that this contention is inconsistent with both the ordinary view and the tax treatment of this type of transaction.

It has been said that "in popular parlance no one would ordinarily use the words 'canceled or reduced' in speaking, for example, of the conversion of debt into stock in a purely capital transaction." Darrell, *Discharge of Indebtedness and the Federal Income Tax*, 53 Harvard L. Rev. 977, 1009. The reason for this is, we submit, that those words import a finality which is lacking in a capital readjustment of this kind. Even though the stock had a readily ascertainable cash value, the conversion would not ordinarily be regarded as involving a payment of that amount and a forgiveness or cancelation of the remainder of the debt. It would normally be considered to involve neither payment nor forgiveness, but rather a "reshuffling of a capital structure" (*Helvering v. Southwest Consolidated Corp.*, 315 U. S. 194, 202) entailing postponement of a final closing of the transaction between the parties.

So far as tax treatment is concerned, it is hardly necessary to point out that for many years exchanges of stock for bonds pursuant to recapitalization or similar reorganization plans have been treated as continuing, rather than

[2] It is to be noted that the word "forgiveness" is used in the Report of the Senate Judiciary Committee, quoted at p. 33 of the taxpayer's brief.

closed, transactions for federal income tax purposes. See Section 202(b) of the Revenue Act of 1918, c. 18, 40 Stat. 1057. The loss technically sustained by the bondholder if the fair market value of the stock which he receives is less than the cost of his bonds is not "recognized" and may not be deducted on his tax return. He is not treated as having received payment or satisfaction in part and forgiven the balance of the debt, but, on the contrary, is treated as if there had been no change whatever in his position vis-à-vis the corporation. And, as we have shown elsewhere in this brief (*supra*, pp. 7-8) a substitution of stock for bonds in a capital readjustment has, except for the decision below, consistently been regarded by the Board of Tax Appeals and the courts—and, until recently, by the administrative authorities as well—as wholly without significance to the corporation concerned.

We submit that under the circumstances it would require far plainer language than is to be found in Section 270 to justify the conclusion that a forgiveness or cancelation of indebtedness measured by the difference between the face amount of the debt and the fair market value of the stock should be deemed to take place, for the purposes of that section, in a case like the present. It is pure fiction to say that a corporation pays out anything when it issues its own stock. See *Liquid Carbonic Corp* v. *Commissioner*, 34 B. T. A. 1191, 1196. Certainly it realizes neither gain nor loss by so doing. Reg. 111, Sec. 29.22(a)—15. Indulgence in the fiction is, we submit, permissible only when the transaction is one which can be treated in all respects as equivalent to an issuance of the stock for cash followed by application of the cash to the purpose for which the stock is issued.[3] That condition does not exist in the case of a recapitalization, since the retirement of bonds with cash would have tax

[3] Compare treatment of unamortized discount upon retirement of bonds with cash proceeds of sale of stock (*The National Tile Co.* v. *Commissioner*, 30 B. T. A. 32) with treatment upon exchange of stock for bonds in a recapitalization (*Liquid Carbonic Corp.* v. *Commissioner*, *supra*.)

results materially different from those obtaining where bonds are retired with stock in a capital transaction.

We submit that the situation here is not, as has been suggested, at all comparable to a discharge of indebtedness by a transfer of property in kind. In the case of such a transfer, there is a severance of assets from the debter corporation, with resulting gain or loss which is recognized as to both debtor and creditor. The transaction may be analyzed as equivalent to a sale of the property for cash which is used to discharge the indebtedness. See Reg. 111, Sec. 29.113(b)(3)-1(E).[4] That is not true with respect to a capital readjustment. A transfer of an undivided interest in the corporation is altogether different from a severance and transfer of particular assets.

It should be noted, also, that the question whether indebtedness is canceled or reduced within the meaning of Section 270 when stock is issued to the creditor in a transaction not qualifying as a capital transaction—as, for example, when stock is issued in satisfaction of general unsecured claims—is not involved in the present case. The difference between the two situations is significant. When stock is issued to unsecured creditors, it is treated like cash or other property in determining the tax status of the recipients, and for that reason there may be justification for treating it like cash or other property in determining the tax results to the debtor.[5]

[4] This provision of the regulations is taken almost verbatim from the Ways and Means Committee Report on the Revenue Act of 1939, H. Rep. No. 855, 76th Cong., 1st Sess., p. 25. The courts have generally held, however, that a transfer of assets in satisfaction of debt constitutes a sale of the assets for the amount of debt. See *Rogers* v. *Commissioner*, 103 F. (2d) 790 (C. C. A. 9th), cert. den. 308 U. S. 580; *Peninsula Properties Co Ltd.* v. *Commissioner*, 47 B. T. A. 84. On that theory there would appear to be a payment in full from the standpoint of the debtor.

[5] It would seem that the Ways and Means Committee must have been thinking of this kind of transaction when, in its report on the 1939 Act, it spoke of cases in which "a discharge of indebtedness is accomplished by the transfer by the debtor of property in kind,

The court below appears to have paid no attention to the fact that a substitution of stock for bonds in a reorganization is not treated as a closed transaction for tax purposes. There is, we submit, nothing "illogical" or "unfair" in retaining as the tax basis of a company's assets an amount greater than their value as of the date of a reorganization, when the holders of the company's securities are not permitted for tax purposes to write down their investments to a basis commensurate with current values. Particularly is this true in a case like the present one, where the creditors who have sustained the "loss" have become the owners of virtually all the stock of the corporation and will be the persons principally affected by any reduction in the basis of the company's assets.

Conclusion.

The decision below should be reversed in so far as it holds that there was a cancelation or reduction of indebtedness in this case within the meaning of Section 270 of the Bankruptcy Act, as amended.

Respectfully submitted,

H. Brian Holland,
Amicus Curiae.

Homer Hendricks,
Of Counsel.

---

such as by the issue of its own stock." H. Rep. No. 855, 76th Cong., 1st Sess., p. 25. Even as applied to the issuance of stock to general creditors, the language seems singularly inappropriate. As applied to an exchange of stock for bonds in a recapitalization or reorganization, it seems utterly inconsistent with the principles established by the Courts. See comment in Surrey, *The Revenue Act of 1939 and the Income Tax Treatment of Cancellation of Indebtedness*, 49 Yale L. J. 1153, 1172. Note, also, that when the committee statement was incorporated, almost verbatim, in the regulations, the words "such as by the issue of its own stock" were omitted. Reg. 111, Sec. 29.113(b)(3)-1(E).

APPENDIX.

Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1:

Sec. 268. Except as provided in section 270 of this Act, no income or profit, taxable under any law of the United States or of any State now in force or which may hereafter be enacted, shall, in respect to the adjustment of the indebtedness of a debtor in a proceeding under this chapter, be deemed to have accrued to or have been realized by a debtor, by a trustee provided for in a plan under this chapter, or by a corporation organized or made use of for effectuating a plan under this chapter by reason of a modification in or cancelation in whole or in part of any of the indebtedness of the debtor in a proceeding under this chapter. (11 U. S. C., Sec. 668)

Sec. 270. [as further amended by the Act of July 1, 1940, c. 500, 54 Stat. 709]. In determining the basis of property for any purposes of any law of the United States or of a State imposing a tax upon income, the basis of the debtor's property (other than money) as is transferred to any person required to use the debtor's basis in whole or in part shall be decreased by an amount equal to the amount by which the indebtedness of the debtor, not including accrued interest unpaid and not resulting in a tax benefit on any income tax return, has been canceled or reduced in a proceeding under this chapter, but the basis of any particular property shall not be decreased to an amount less than the fair market value of such property as of the date of entry of the order confirming the plan. Any determination of value in a proceeding under this chapter shall not be deemed a determination of fair market value for the purposes of this section. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe such regulations as he may deem necessary in order to reflect such decrease in basis for Federal income-tax purposes and otherwise carry into effect the purposes of this section. (11 U. S. C., Sec. 670)

SUPREME COURT OF THE UNITED STATES.

Nos. 28, 29.—October Term, 1944.

Claridge Apartments Company, vs. Commissioner of Internal Revenue. } On Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

[December 4, 1944.]

Mr. Justice Rutledge delivered the opinion of the Court.

The issues arise out of deficiency assessments made in respect to petitioner's federal income and excess profits taxes for the years 1935 to 1938 inclusive. They involve the applicability of Section 270 of the Bankruptcy Act, as amended,[1] so as to require reduction of depreciation allowances claimed.

---

[1] Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938, c. 575, 52 Stat. 904, and the Act of July 1, 1940, c. 500, 54 Stat. 709, 11 U. S. C. §§ 668, 670. Section 270 is complementary to Section 268, with which originally it was enacted as part of Chapter X of the Chandler Act. The two sections are as follows, the italicized portion of 270 constituting the whole of the amendment made in 1940.

"Sec. 268. Except as provided in section 270 of this Act, no income or profit, taxable under any law of the United States or of any State now in force or which may hereafter be enacted, shall, in respect to the adjustment of the indebtedness of a debtor in a proceeding under this chapter, be deemed to have accrued to or to have been realized by a debtor, by a trustee provided for in a plan under this chapter, or by a corporation organized or made use of for effectuating a plan under this chapter by reason of a modification in or cancelation in whole or in part of any of the indebtedness of the debtor in a proceeding under this chapter."

"Sec. 270. In determining the basis of property for any purposes of any law of the United States or of a State imposing a tax upon income, the basis of the debtor's property (other than money) or of such property (other than money) as is transferred to any person required to use the debtor's basis in whole or in part shall be decreased by an amount equal to the amount by which the indebtedness of the debtor, not including interest accrued unpaid and not resulting in a tax benefit on any income tax return, has been canceled or reduced in a proceeding under this chapter, *but the basis of any particular property shall not be decreased to an amount less than the fair market value of such property as of the date of entry of the order confirming the plan. Any determination of value in a proceeding under this chapter shall not be deemed a determination of fair market value for the purposes of this section.* The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe such regulations as he may deem necessary in order to reflect such decrease in basis for Federal income-tax purposes and otherwise carry into effect the purposes of this section." (Emphasis added.)

The transactions arose in connection with a reorganization proceeding under Section 77 B, 48 Stat. 912. They consisted essentially of petitioner's acquisition of all the assets of the insolvent debtor corporation, by an exchange of its capital stock without par value for the latter's bonds then outstanding. The Commissioner contends that the exchange resulted in a cancellation or reduction of indebtedness within the meaning of Section 270, so as to require a corresponding reduction in the basis of the property transferred. Accordingly he now urges that the assessment should be made, as the section requires, upon the basis of the fair market value of the property.[2] The taxpayer's claim is made on the higher basis of the debtor corporation, in the view that Section 270 is not applicable to such a transaction.

This difference has been the basic one between the parties in proceedings before the Tax Court,[3] the Circuit Court of Appeals and here. Others include a similar question with respect to the extinction of the debtor's liability for the accrued unpaid interest on the bonds and whether Section 270 is made applicable retroactively to the years prior to 1938, by virtue of the provisions of Section 276c(3) of the Chandler Act.[4]

The Tax Court decided the principal issue on the merits in favor of the taxpayer, except with respect to the accrued interest. Cf. also *Capento Securities Corp.* v. *Commissioner*, 47 B. T. A. 691, affirmed, 140 F. 2d 382. It likewise limited the application of Section 270 to the year 1938 and succeeding years. 1 T. C. 163. The Court of Appeals reversed the Tax Court's decision in both respects, holding there was a cancellation of indebtedness with respect to the unpaid principal[5] and that Section 270 was applicable retroactively to require the prescribed reduction in basis for each of the tax years in question. 138 F. 2d 962. Certiorari was granted, 321 U. S. 759, because of the importance of the questions presented

[2] Cf. note 1 *supra*. Originally the Commissioner contended that the taxpayer's basis for depreciation was the market value of the property on acquisition in 1935 and this was a major issue before the Tax Court, cf. 1 T. C. 163. But the Tax Court held petitioner had acquired the assets in connection with a reorganization as comprehended by Section 112(g) of the Revenue Act of 1934, and that therefore its basis was the adjusted basis in the hands of the debtor corporation. This ruling was not contested on appeal and is not in question here.

[3] Cf. note 2 *supra*.

[4] The section is set forth in Part III of the opinion.

[5] Consequently it made no ruling with reference to the accrued interest, since the amount of the principal held to have been "cancelled" was more than sufficient to bring the basis down to the fair market value in 1935.

and a conflict on the question of retroactivity.[6] The facts are stated shortly in the margin, to give concrete perspective.[7]

I.

Petitioner earnestly argues that the Tax Court's decision, so far as this was in its favor, should be affirmed on the authority of *Dobson* v. *Commissioner*, 320 U. S. 489, though in other respects it seeks a reversal of that court's judgment.[8] For reasons presently to be stated, we think the case must be disposed of in its entirety by the application of Section 276(c)(3), which determines the extent to which Sections 268 and 270 are applicable in point of time. Accordingly, we are not required to pass upon the merits of the other interesting issues or whether they fall within the *Dobson* admonition. On the other hand, the question of the applicability of Sections 268 and 270, under the terms of Section 276(c)(3), to the transactions involved in this case obviously is one of law and of a sort not requiring the specialized experience of the Tax Court to determine. Furthermore, it involves making an accommodation between the conflicting policies, in part, of the

[6] Cf. Commissioner v. Commodore, 135 F. 2d 89 (C. C. A. 6th), holding that Section 276(c)(3) does not make Sections 268 and 270 retroactively applicable to tax years prior to 1938. The importance of the questions for the future has been minimized by repeal of Section 270 by Section 121 of the Revenue Act of 1943, Pub. L. 235, 78th Cong., 2d Sess.

[7] The property consists of an apartment building, with furnishings, in Chicago. It was constructed in 1924 by the Claridge Building Corporation at a cost in excess of $385,000. The corporation at that time issued its 6½ per cent first mortgage bonds for $340,000. By October 1, 1931, the bonds outstanding amounted to $277,000. In consequence of defaults, on that date the trustee filed his bill of foreclosure, took possession of the property, and thereafter collected the rents. A decree for foreclosure was entered the following February, but there was no sale and the foreclosure proceeding was never consummated.

On June 16, 1934, the Building Corporation filed its voluntary petition under Section 77 B. In November of that year a plan of reorganization was agreed upon, which was confirmed and approved May 14, 1935. Pursuant to this the taxpayer corporation was organized and the property was transferred to it. Ninety per cent of its shares were issued to trustees for depositing bondholders and to nondepositing bondholders, on the basis of one share of stock for each $100 face amount of bonds; and ten per cent of the stock was issued to the shareholders in the old corporation. The final decree in the Section 77 B proceeding was entered March 1, 1937.

According to findings of the Tax Court, the fair market value of the building, as of May 14, 1935 (when the plan was confirmed, cf. § 270, note 1 *supra*), was not in excess of $141,000. The adjusted basis of the taxpayer's predecessor in that year was $239,377.33, at which time the building had a remaining useful life of twenty-five years. The fair market value of petitioner's stock did not exceed $45 per share in 1935. The Tax Court also found that the Claridge Building Corporation was insolvent throughout the reorganization proceedings.

[8] Cf. text *infra* at note 37.

bankruptcy laws and the revenue enactments. Sections 268 and 270 are integral parts of the former, though related in subject matter to the latter, and were so placed for purposes relevant primarily to that legislation. For these reasons the issue falls beyond the scope of the *Dobson* case.

II.

The question presented by Section 276c(3) must be determined in the light of the problem created by Sections 268 and 270. A statement of their history is necessary to a general understanding of that problem. It stems basically from *United States v. Kirby Lumber Co.*, 284 U. S. 1, and subsequent decisions which have applied the principle of that case.[9] By them a corporation may realize income from the cancellation or reduction of indebtedness, depending upon the circumstances in which the transaction occurs. However, the line between income producing reductions and others is not precise or definite and great uncertainty prevailed concerning it, both in 1934 when Section 77 B was enacted and in 1938 when Chapter X of the Chandler Act was adopted. The uncertainty was greatest perhaps in relation to transactions occurring in the course of insolvent reorganizations.[10]

Some of the obscurity has been created by the very legislation enacted to remove it. This has been true of the successive "reorganization" provisions, including those for "nonrecognition" and for transfer of "basis," which have appeared in the various revenue acts from 1918 (cf. 40 Stat. 1057) forward. Closely related, as these have been, to the problem whether income is realized by the cancellation or reduction of indebtedness in connection with a reorganization, they have tended to obscure if not to blot out that problem altogether in situations covered by their terms.[11]

By and large the provisions are the product of and have reflected efforts at compromise, none too successful, between the

[9] Cf., e. g., Helvering v. American Dental Co., 318 U. S. 322; Kraman Dev. Co., 3 T. C. 342; Paul, Debt and Basis Reduction under the Chandler Act (1940) 15 Tulane L. Rev. 1, 5, and authorities cited in notes 17, 19.

[10] Cf. Paul, *op. cit. supra*, note 9; Darrell, Discharge of Indebtedness and the Federal Income Tax (1940) 53 Harv. L. Rev. 977; Darrell, Creditors' Reorganizations and the Federal Income Tax (1944) 57 Harv. L. Rev. 1009; Banks, Treatise on Bankruptcy for Accountants (1939) 80-92.

[11] By assuming the existence of income or other taxable gain, but providing for nonrecognition, the inquiry whether gain or profit actually has accrued is wholly avoided.

conflicting pulls of policy involved in the revenue acts and in the bankruptcy legislation. They were drawn and enacted however as parts of the revenue laws and have reflected increasingly the policy of that legislation.[12] Accordingly, the succession of statutes relating to this field, prior to Sections 268 and 270, represents a series of shifts in the legislative pendulum from initial broad tax relief, to encourage needed reorganizations, toward narrowed exemption, in order to discourage use of reorganization for evasion of taxes. The general purpose of the provisions, however, was to postpone the tax consequences which otherwise might ensue upon transactions occurring in such circumstances that immediate imposition was regarded as economically unjustifiable.[13] This continued in the 1934 general revision,[14] which remained in effect during the period of this litigation.

In some respects, as compared with the preexisting legislation, the 1934 provisions broadened, but in others they restricted the scope of application of the principles of nonrecognition and transfer of basis.[15] Nevertheless, they were applicable to all exchanges falling within their terms, whether or not the plan was executed in connection with a judicial proceeding. Consequently, when in June, 1934, Section 77 B was adopted, the 1934 revenue provisions became applicable to reorganizations under that section, but only if they met the tests prescribed in the revenue acts, including such judicially interpolated matters as "continuity of interest" and "business purpose."[16] Many 77 B reorganizations did not qualify under these tests or on substantial grounds were thought not to do so.

---

[12] Cf. authorities cited note 10 *supra*.

[13] Cf. Paul, Studies in Federal Taxation, Third Series, 4, 5.

[14] §§ 112, 113 of the Revenue Act of 1934, c. 277, 48 Stat. 680, 704, 706.

[15] E. g., Section 112(g) of the 1934 Act redefined what might be a reorganization under the revenue act. Thus Section 112(g)(1)(A) included only statutory mergers or consolidations as revenue reorganizations, but dropped the earlier parenthetical clause; Section 112(g)(1)(B) required that the acquisition of stock or property of another corporation be in exchange solely for all or a part of the *voting* stock of the acquiring corporation to qualify as a reorganization. Helvering *v.* Southwest Consolidated Corp., 315 U. S. 194; cf. § 112(b)(5); Helvering *v.* Cement Investors, Inc., 316 U. S. 527.

[16] Cf. Helvering *v.* Alabama Asphaltic Limestone Co., 315 U. S. 179; Palm Springs Holding Corp. *v.* Commissioner, 315 U. S. 185; Marlborough Investment Co. *v.* Commissioner, 315 U. S. 189; Helvering *v.* Southwest Consolidated Corp., 315 U. S. 194; Darrell, Creditors' Reorganizations and the Federal Income Tax (1940), 57 Harv. L. Rev. 1009, 1032-1033.

The consequence was seriously to clog the use of the 77 B procedure. Obstacles were imposed not only by the differences in the two statutory definitions of "reorganization," but also by ambiguities in each definition which in themselves created considerable areas of uncertainty.[17] And underlying these remained the mystery of when income would be regarded as realized, which continued to haunt reorganizers unsure of whether they could bring themselves within the statutory exemptions. In short, the necessity of squaring the reorganization first with Section 77 B, then with the different terms of the revenue provisions, and the uncertainties involved under each statute in doing this, added to the puzzle of "realized income," made the process of creditors' reorganization under the former act a highly dubious adventure. To an undetermined extent the effect of the revenue act's provisions was to nullify or make impossible of realization the objects of Section 77 B.

In this setting Congress adopted the Chandler Act in 1938. That statute was a general revision of the provisions for bankruptcy reorganization, including those previously made under Section 77 B. One of its principal objects was to encourage the freer use of bankruptcy reorganization in order to avoid unnecessary or premature liquidations. By this time Congress had become aware of the hazardous and hampering effects of the 1934 revenue provisions upon the operation of bankruptcy reorganizations under Section 77 B. The objectives of the Chandler Act, in similar situations, could not be achieved without removal of these impediments. Some provision was essential to prevent them from having the same effects upon the working of the new legislation. Accordingly Section 268 was devised for this purpose and became a part of the Chandler Act itself. It had no other object, and there was no other occasion for its being, than to free Chapter X reorganizations from the tax deterrents, including tax uncertainties, imposed by the existing revenue act provisions.

The relieving effect of Section 268 was confined in three ways, namely, (1) to transactions occurring in a Chapter X reorganization; (2) to transactions involving a modification or a cancellation, in whole or in part, of the debtor's indebtedness; and (3) its benefits were limited to the debtor corporation, the trustee

[17] *Ibid.*

if any, provided for in the plan, and the successor or transferee corporation. Within these limitations the section provided that "no income or profit, taxable under any law . . . shall . . . be deemed to have accrued to or to have been realized by . . ." the parties specified, and thus removed Chapter X transactions from incidence of the uncertainties characterizing the general "reorganization" provisions. One who followed the procedure could be assured he would not thereby run into tax consequences which would be worse than the economic illness requiring that cure.

As it was originally considered by the House Committee, the Chandler Act contained no counterpart of the present Section 270. Had Section 268 thus been left to stand alone, with no accompanying provision for "basis," either there would have been no applicable provision for "basis" or the general "basis" provisions would have remained applicable to Chapter X reorganizations falling within their terms, with the result that they would apply to some Chapter X reorganizations but not to others. The latter view apparently was generally accepted. Under it much of the previous uncertainty would have remained, but with its focus shifted from "realized income" to "basis." Moreover, it was the view of Treasury officials, apparently in the assumption of continued transfer of "basis" under the general provisions, that the effect of Section 268 would be to provide a double deduction in some cases,[18] unless complemented by a corresponding "basis" provision, and thus be unfair to the revenue.

Accordingly the Treasury, and others, made various proposals,[19] which eventuated in the adoption of Section 270 in its original form. This provided for transfer of basis, as did the code provisions, but required that it be decreased *by the amount of the reduction of indebtedness*, a measure at variance with the terms of the code. It was from the requirement of reduction, and the measure provided for it, that new difficulties were derived. Although the only occasion for making a further provision concerning basis arose from the adoption of Section 268 and although the legislative history discloses the purpose of Congress exactly contrary to placing Chapter X reorganizations at radical disad-

[18] Hearings before the House Committee on the Judiciary on H. R. 8046, 75th Cong., 1st Sess., 352-354; Hearings before Subcommittee of Senate Committee on the Judiciary on H. R. 8046, 75th Cong., 2d Sess., 137-139.

[19] See House Committee Hearings, 353-354; Senate Subcommittee Hearings, 145-146.

vantage from others, the literal effect of the original Section 270 came near if not entirely to wiping out the whole benefit conferred by Section 268.[20] Soon it was realized that literal application of the specified new measure of reduction would require decrease of basis in many instances to zero or even to a point below zero, because the amount of the debt cancelled or reduced would equal or exceed the value of the property or that assigned to the basis transferred. Thus, any tax benefit derived from Section 268, in such cases, would be more than offset by the higher taxes resulting in later years from the absence of any depreciation base and in case of sale of the property acquired. And in cases where no benefit could be derived from Section 268, the effect of applying Section 270 was, if not to impose a capital levy,[21] then to deny the new owners equal treatment, not only with other transferees under the code provisions, but with all other taxpayers.

could

Congress, in view of its original object in adopting Section 268, cannot possibly have intended such consequences for Section 270. The cure was worse than the disease.[22] The legislative history gives the clear impression that adoption of the original Section 270 was a plain blunder, the consequences of which were not foreseen, understood or intended by those who finally gave it the form of law.[23]

Legislative relief obviously was in order and was forthcoming at the next session of Congress, in the amendment of Section 270 adding the language giving it its present form.[24] The amend-

[20] H. Rep. No. 2372, 76th Cong., 3d Sess., 2-4; S. Rep. No. 1857, 76th Cong., 3d Sess., 1-5; Hearings before a special subcommittee on bankruptcy and reorganization of the House Judiciary Committee on H. R. 9864, 76th Cong., 3d Sess., 3, 5-11, 13-14, 16, 18-31, 54; cf. Paul, Debt and Basis Reduction under the Chandler Act (1940) 15 Tulane L. Rev. 1, 5.

[21] Cf. Darrell, Creditors' Reorganizations and the Federal Income Tax (1940) 57 Harv L. Rev. 1009, 1016.

[22] Paul, Debt and Basis Reduction Under the Chandler Act (1940) 15 Tulane L. Rev. 1, 5.

[23] Hearings before the House Committee on the Judiciary on H. R. 8046, 75th Cong., 1st Sess., 352-354; Hearings before Subcommittee of Senate Committee on the Judiciary on H. R. 8046, 75th Cong., 2d Sess., 137-139, 145-146; Hearings before a special subcommittee on bankruptcy and reorganization of the House Judiciary Committee on H. R. 9864, 76th Cong., 3d Sess., 52-59, 66-67. A significant letter written by Congressman Chandler shortly after the passage of the Chandler Act was submitted at the 1940 Hearings (Hearings on H. R. 9864, at 52) and was received by the Subcommittee into the record. For some reason it was not published in the record, although the Chandler letter was referred to in a letter which was published (Hearings on H. R. 9864, at 56). The Chandler letter may be found in Banks, Treatise on Bankruptcy for Accountants (1939) 84-85.

[24] Cf. note 1 *supra*.

ment removed some, but not all of the uncertainty confronting Chapter X reorganizers. It placed a floor to the amount of reduction required. In no case would basis be reduced below fair market value. But this was only partial cure of the original infirmities. Above the floor, debt cancellation remained the measure of reduction, thus keeping Chapter X reorganizations generally at a disadvantage with those taking place under the code. But, what was more important, the chief hazard remained, namely, whether Section 270 was intended to operate only where Section 268 was effective to afford actual tax benefit or, as the Government contends, regardless of whether such relief was afforded. And in this case the hazard has been realized in assessment.

III.

With this background we turn to Section 276c(3). By their own terms Sections 268 and 270 apply only to transactions arising in connection with proceedings "under this chapter," that is, Chapter X of the Chandler Act. The instant transactions arose in proceedings, not under Chapter X, but under Section 77B, which had been closed by final decree March 1, 1937. The Chandler Act became effective September 22, 1938. Accordingly, Sections 268 and 270, of their own force, are not applicable to these transactions. If they are so at all it is by virtue of Section 276c(3), which the Government says must be construed to extend their operation retroactively to include these facts. This petitioner disputes.

The language immediately in question is the italicized part of subdivision (3), as follows:

(c) the provisions of Sections 77 A and 77 B . . shall continue in full force and effect with respect to proceedings pending . . upon the effective date of this amendatory Act, except that

(3) *sections 268 and 270 of this Act shall apply to any plan confirmed under section 77 B before the effective date of this amendatory Act and to any plan which may be confirmed under section 77 B on and after such effective date*, except that the exemption provided by section 268 of this Act may be disallowed if it shall be made to appear that any such plan did for one of its principal purposes the avoidance of income taxes, and except further that where such plan has not been confirmed on and after such effective date, section 269 of this Act shall apply where practicable and expedient. [Emphasis added.] 52 Stat. 905, 11 U. S. C. § 676.

Three constructions have been advanced. Shortly stated they are that Sections 268 and 270 apply to transactions involved in 77 B proceedings (1) only if the proceedings were pending September 22, 1938; (2) only for 1938 and later tax years, but including transactions in proceedings closed before September 22, 1938; (3) for all tax years from 1934 forward as to transactions in all proceedings in which a plan had been or should be confirmed, regardless of whether the proceedings were pending or had been closed on September 22, 1938.

The petitioner advances the first two views, alternatively; the Government the third. The Government interprets the italicized language as if it were wholly disconnected from and unrelated to the preceding portions of Section 276c, in other words, as an entirely independent provision unlimited by its statutory context. Petitioner, on the other hand, regards it as merely a part or phase of Section 276c,[25] and thus reaches the exactly contrary view of its meaning. The statute, it says, refers in the first paragraph of "c" to "proceedings pending" under 77 B and, to quote the brief, "exceptions (1), (2), and (3) are keyed into this first paragraph and refer to pending proceedings also. They merely except from the *pending cases* those to which 77 B is not to apply. Since (*) deals only with pending cases and not-closed cases, they refer also to pending cases." The Government concedes there is force in this view, though it suggests, we think untenably,[26] that the

[25] Petitioner's statement of the argument does not take account expressly of the obvious difference between what he calls "exceptions (1) and (2)," on the one hand, and "exception (3)," on the other. (1) and (2) are clearly true substantive exceptions to the general mandate of "c." That is, they provide instances in which Section 77 B shall not continue to operate, contrary to the general provision of "c" for its continued effectiveness in pending proceedings. Like effect however cannot be given to (3). It does not purport expressly to provide for nonoperation of 77 B. Rather its force is to provide for an extended operation of Sections 268 and 270, with reference to 77 B proceedings.

The formal difficulty however is more apparent than substantial. Nothing in (3) is at all inconsistent with its limitation to pending 77 B proceedings. And the formal connection with "c," though awkwardly made, affords some evidence of purpose to limit the effects of (3) to such proceedings. The same consequence, however, would seem to be dictated, if the formal connection as an "exception" to "c," were disregarded and (3) were treated as a separate subsection, like the corresponding provisions of other chapters. Cf. note 35 *infra*. The substantive relationship with the subject matter and purpose of the preceding provisions of the section as a whole would remain. Cf. text *infra* Part III.

[26] It is true petitioner did not present this interpretation in the Court of Appeals or in the Tax Court. It was advanced as a question presented in the petition for a writ of certiorari, the matter has been argued here, and

question is doubtfully open. The Court of Appeals accepted the Government's view, the Tax Court the alternative or second view advanced by the taxpayer. We think neither can be accepted and that the effect of Section 276c(3) is to confine the application of Sections 268 and 270, in 77 B proceedings, to proceedings pending when the Chandler Act became effective.

If Sections 268 and 270 were to be applied to all reorganizations completed under Section 77 B, literally they would cover all such transactions running back to 1934, when the latter section was enacted. As to proceedings closed when the Chandler Act took effect, this would involve disturbance of tax consequences already settled for five years, unless cases are excepted where the statute of limitations had run.[27] We have no means of knowing how much resurrection of old claims or generation of new ones in respect to settled matters this would create. Nor did the authors of the Chandler Act. But, from the circumstances of the time and the very necessities which brought about adoption of Section 77 B, the volume must have been considerable.

To construe Section 276c(3) to produce such consequences in no way would further the primary objects of Sections 268 and 270, which were to encourage use of Chandler Act procedures, at the same time preventing their abuse for tax advantage. Rather it would pervert those sections by changing their character, to the extent of their retroactive operation, from relief provisions to purely revenue measures of the worst type. In adopting them Congress was not uprooting the whole tax past of reorganized debtors and their creditors. It was, or purported to be, giving

---

the Government does not claim surprise. The issue of retroactivity and proper interpretation of Section 276c(3) has been a focal point of the controversy in the Court of Appeals and in the Tax Court. Petitioner has maintained throughout that there was no tax deficiency for either 1938 or any prior year. Thus the issue has been presented at all stages, although a theory to sustain petitioner's position concerning it has been advanced here which was not put forward in prior stages of the litigation.

[27] It may be noted that the terms of Section 276c(3) make no provision concerning the statute of limitations. They apply literally to all prior 77 B proceedings. The Commissioner and the Treasury have not interpreted the section to make Sections 268 and 270 apply beyond the time when the general statute has run. But this interpretation is not necessarily controlling in the face of the breadth of the language used, if it is taken as unlimited by its context. No assessment was made in this case for 1934 because the petitioner corporation was not organized until 1935.

relief from harsh or uncertain tax consequences to persons reorganizing presently or in the future.[28]

The language does not require such unlimited construction. The words are not directed expressly to past tax years. Nor are they focused upon transactions in closed proceedings. It is true that Section 276c(3), if construed as though it were entirely independent of the remainder of Section 276c, does not refer explicity to *pending* 77 B proceedings, except in its concluding clause. Yet it is part and parcel of that section, which in all other respects deals only with pending and future proceedings, not with closed ones. And the concluding clauses of (3) afford additional evidence that it was intended to apply only to plans confirmed or to be confirmed in pending proceedings, as does also its setting in the context of Section 276 as a whole.[29]

Thus Section 276, in subsections a, b and c [excepting only Section 276c(3)], deals exclusively with pending or future proceedings. Congress' concern in "a" was that Chapter X should

[28] Cf. Part II of this opinion.

[29] The section comprises the whole of Article XVI of Chapter X, entitled "When Chapter Takes Effect." It is as follows:

"Sec. 276. a. This chapter shall apply to debtors by whom or against whom petitions are filed on and after the effective date of this amendatory Act and to the creditors and stockholders thereof, whether their rights, claims, or interests of any nature whatsoever have been acquired or created before or after such date;

"b. a petition may be filed under this chapter in a proceeding in bankruptcy which is pending on such date, and a petition may be filed under this chapter notwithstanding the pendency on such date of a proceeding in which a receiver or trustee of all or any part of the property of a debtor has been appointed or for whose appointment application has been made in a court of the United States or of any State;

"c. the provisions of sections 77 A and 77 B of chapter VIII, as amended, of the Act entitled 'An Act to establish a uniform system of bankruptcy throughout the United States', approved July 1, 1898, shall continue in full force and effect with respect to proceedings pending under those sections upon the effective date of this amendatory Act, except that—

"(1) if the petition in such proceedings was approved within three months prior to the effective date of this amendatory Act, the provisions of this chapter shall apply in their entirety to such proceedings; and

"(2) if the petition in such proceedings was approved more than three months before the effective date of this amendatory Act, the provisions of this chapter shall apply to such proceedings to the extent that the judge shall deem their application practicable; and

"(3) *sections 266 and 270 of this Act shall apply to any plan confirmed under section 77 B before the effective date of this amendatory Act and to any plan which may be confirmed under section 77 B on and after such effective date*, except that the exemption provided by section 268 of this Act may be disallowed if it shall be made to appear that any such plan had for one of its principal purposes the avoidance of income taxes, and except further that where such plan has not been confirmed on and after such effective date, section 269 of this Act shall apply where practicable and expedient." (Emphasis added.) 52 Stat. 905, 11 U. S. C. § 676.

apply notwithstanding the substantive rights of debtors, creditors and others had arisen before the effective date of the Act. In "b" it was that the pendency of bankruptcy and receivership proceedings should not defeat resort to the Chandler Act's provisions; in "c" it was with an accommodation of the provisions of Sections 77 A and 77 B and those of the Chandler Act as to pending proceedings. Apart from Section 276c(3), therefore, the whole problem treated in Section 276 was to give the Chandler Act as wide room as possible for future operation, notwithstanding the previous vesting of substantive rights or institution of bankruptcy or reorganization proceedings. Congress was concerned with the Act's future operation, as a remedial provision, not as a method of creating new and retroactive substantive rights and liabilities.

This being true, it is difficult to understand why Congress might wish to follow exactly the opposite policy with reference to newly created substantive tax rights and liabilities. It would seem wholly incongruous to imply such a purpose in the absence of language unquestionably requiring it, both as a matter of general legislative polic, and, more especially, as one of accommodation with the purposes of the particular legislation. In short, apart from subdivision (3), relating to tax incidents of reorganization, all of Section 276 was devoted entirely to matters affecting pending and future proceedings. We can find reason for no other view than that this was true also of the provisions for application of the new tax features.

This is borne out by the concluding clauses of Section 276c(3) itself, which provide for exceptions to its operation. The second exception in terms relates only to pending proceedings. It contemplated future confirmation exclusively. The first exception, standing alone, literally could be applied in the case of a closed proceeding. But reaching such cases was not a necessary reason for including it. Such a reason existed, however, in the necessity for covering plans already confirmed in pending proceedings, unless parties then reorganizing under Section 77 B were to be treated differently from others reorganizing at the same time under Chapter X. The two exceptions thus dovetailed to provide complete coverage for disallowing the exemption given by Section 268 in pending proceedings. They comprehended distinct situations and

provided different sanctions,[30] all however consistent with application only in pending proceedings. Thus the entire language of Section 276c(3) was capable of full and complete application, although confined to pending proceedings. To give it greater scope, retroactively, is required neither by the terms nor by the purposes of the specific provision or others related to it in context or by reference.

That the narrower application was the intended one seems most apparent when the nature of the problem with which Section 276c(3) sought to deal is considered. There was no problem, arising from enactment of the Chandler Act, with reference to closed 77 B proceedings. And there was no reason originally, when Section 268 stood alone, for giving the relief it afforded to taxpayers involved in such proceedings. Nothing in the legislative history of Section 268, or of Section 270, shows any concern, intent or occasion for dealing with such taxpayers. The whole desire related rather, as has been shown, to taxpayers who might be adversely affected by the general revenue provisions in taking advantage of the Chandler Act.

However, that Act itself created another problem, namely, how far its terms should apply in pending 77 B proceedings. Congress decided that the Chandler procedure should be followed as far as possible, though not to the extent of displacing the 77 B procedure in reorganizations far advanced.[31] The same policy was framed for other chapters. Consequently Sections 276c(1) and (2) were included, as were also comparable provisions in other chapters.[32] With them in, the problem was presented whether the Chandler Act's tax relief provisions, including Sections 268 and 270, should apply also in the pending 77 B proceedings and, if so, to what extent—only to those converted into Chandler Act proceedings by Section 276c(1), or also to those partially converted under Section 276c(2) by an exercise of judicial discretion and those falling within 276c(2) but so nearly completed or otherwise situated that application of the Chandler Act in any respect

[30] I. e., refusal of confirmation where the plan had not been approved (cf. § 269) and disallowance of the tax exemption, if the plan had been confirmed. For tax purposes these come to the same result, a fact also indicative that both exceptions were intended to operate within the general limitation of pending proceedings.

[31] S. Rep. No. 1916, 75th Cong., 3d Sess., 39; Hearings before the House Committee on the Judiciary on H. R. 8046, 75th Cong., 1st Sess., 375-376, 383; Hearings before Subcommittee of the Senate Committee on the Judiciary on H. R. 8046, 75th Cong., 2d Sess., 6-7.

[32] Cf. note 34 and text *infra*.

would be impracticable and therefore 77 B would continue exclusively effective.

Although these pending 77 B proceedings, and particularly those nearing completion, having been already begun, were generally without the scope of the encouragement Sections 268 and 270 were intended to give to persons contemplating reorganization, Congress undoubtedly felt it would be unfair to give the relief to taxpayers following the Chandler Act procedure, but deny it to persons following that of 77 B at the same time. To make this discrimination might force conversion of pending 77 B proceedings into Chapter X proceedings, solely on account of tax consequences, where but for them such conversion would not be proper or desirable. Accordingly, by Section 276c(3) Congress extended the tax relief provided by Sections 268 and 270 also to pending 77 B proceedings in order to put persons continuing 77 B reorganization on the same basis with others proceeding under Chapter X. There was no other occasion or object for the extension.

In view of these considerations, both of context and of consequence, we do not think Section 276c(3) can be regarded as applicable to closed proceedings. The purpose, rather, as in the other provisions of Section 276, was to look to the future and in doing so to make the necessary adjustment, so far as was possible, between the provisions of the Chandler Act and pre-existing laws as to proceedings pending when the former took effect. Thus construed, Section 276c(3) becomes consistent, both in form and in the purpose and effects of applying the new tax provisions, with the other provisions of Section 276 and with the general policy of the Chandler Act as to applicability of its terms.[33] Any other view would make Section 276c(3) a unique provision in the statute's setting, and one inconsistent with, if not also contradictory to, the Act's general purposes and the limited objects of the particular provisions immediately in issue.

Further support for this view would seem to be afforded, when the consequences of applying it or the contrary one to similar pro-

[33] "Except as otherwise provided in this amendatory Act, the provisions of this amendatory Act shall govern proceedings so far as practicable in cases pending when it takes effect; but proceedings in cases then pending to which the provisions of this amendatory Act are not applicable shall be disposed of conformably to the provisions of said Act approved July 1, 1898, and the Acts amendatory thereof and supplementary thereto." Act of June 22, 1938, c. 575, § 6b, 52 Stat. 940.

visions appearing in other chapters of the Chandler Act[34] are taken into account. If those provisions are to be given retroactive application comparable to what the Government says should be given to Sections 268, 270 and 276c(3), the disruption of settled tax situations, by virtue of the Chandler Act's adoption, may be multiplied many times over what would follow from giving such an effect only to Sections 268, 270 and 276c(3). Although the immediate consequences of decision in this case are limited to the specific effects of these sections, it is at least doubtful that they could be given a different construction, as to retroactive application, from what might be given to the comparable sections of other chapters. The possibility that uniform interpretation may be required gives pause, at least, before adopting a view in this case which, if extended to the other provisions, would open so wide a door for retroactive taxation.

As against this interpretation, the Government's argument rests primarily on two bases: (1) that the words of Section 276c(3) require its construction; and (2) that unless this is given, discriminations as to tax consequences will be created between taxpayers involved in closed proceedings and those in pending and future ones, with the result that mere speed in getting the proceedings pending prior to September 22, 1938, to a final decree would determine whether taxpayers equally de-

[34] Chapters XI, XII and XIII deal respectively with Arrangements, Real Property Arrangements by Persons Other Than Corporations, and Wage Earners' Plans. Each of these chapters embodies sections corresponding in principle to Sections 268, 270 and 276. Those comparable to Section 276 are Section 399 in Chapter XI, Section 526 in Chapter XII, and Section 686 in Chapter XIII. Each, like Section 276, contains the whole of an article entitled "When Chapter Takes Effect." Each contains four subsections (with a fifth in Section 686), corresponding to subsections a, b and c of Section 276 *and subdivision (3)* of that section. Thus, Sections 399(4), 526(4), and 686(4), correspond to subdivision 276c(3). They differ from it however in that they are formally independent subsections, whereas Section 276c(3) is formally a part of Subsection 276c, dependent upon its general mandate, and thus, perhaps even more clearly limited by the preceding provisions. Cf. note 25 *supra*.

Sections 268, 270 and 276, therefore, do not represent isolated instances of legislation peculiar to corporate reorganizations under Chapter X. They are rather particular instances of a general pattern of legislation, relating to a common problem running through Chapters X, XI, XII and XIII, namely, to what extent the Chandler Act's terms should be applied to pending reorganizations, arrangements, wage earners' plans, etc. Because of detailed differences in the situations affected, the provisions corresponding to Sections 268, 270 and 276 vary somewhat in detail. But the similarities rather than the variations, whether in situation or in terms, are significant for present purposes.

serving would be afforded the relief provided by Sections 268 and 270."

The answers are obvious. In the first place, the wording of Section 276c(3) does not require the Government's construction. That view can be taken only if subdivision (3) is torn, formally and substantively, from its context in the statute and the problems with which these surrounding provisions, including Sections 268 and 270, undertook to deal. Thus to treat the provision not only would disregard the purposes of all these related provisions. It would convert subdivision (3), in its practical application, into an entirely independent tax measure, solely in the nature of an amendment to the general revenue legislation, and with the harshest retroactive tax consequences. This in fact seems to be the Government's view of the character of the legislation.[35] But that view wholly disregards the fact that neither Sections 268 and 270 nor Section 276c(3) had any purpose originally or later merely to produce larger revenues or to operate exclusively as revenue measures. It is true they modified the preexisting revenue provisions, so far as they were applicable by their terms, to do so. But this was a function of their primary object, which was to give relief to parties undertaking reorganization, not simply to impose new and different taxes upon them, much less to do so with respect to transactions long since settled both as to taxes and as to reorganization. The objects of Section 276c(3) cannot be ignored or distorted by thus stripping the provision, formally and substantively, from its statutory setting and the limitations this clearly imposes.

So far as respects the Government's concern over the possible discriminations which will be created between taxpayers by ac-

[35] Thus, in its brief the Government asserts, concerning petitioner's argument that Sections 268 and 270 apply only to "pending" proceedings: "This contention, although plausible, neglects the fact that Sections 268 and 270 are *essentially tax provisions.*" (Emphasis added.) To this it may be answered that the sections, in origin, purpose and function were "essentially reorganization provisions" or, to put it differently, "essentially tax relief provisions." The Government's emphasis upon the sections as taxing measures ignores their primary object and function, which were to provide tax relief for parties undertaking reorganization and to prevent the clogging effects of the existing tax laws upon the operation of the Chandler Act. It also fails to note that retroactive application, in closed proceedings, could have no possible relation to the latter aim. The matter is one of emphasis. But it is not permissible, in construing provisions designed to encourage reorganization, by giving relief from taxes, to take them by such an emphasis as if they were framed exclusively for raising revenue.

ceptance of petitioner's view, it is perhaps enough to say that some such discrimination is inevitable with whatever solution may be accepted; and we think what follows from applying Sections 268 and 270 only to "pending proceedings" not only is preferable to any other but is most consistent with the normal course of legislation. Retroactivity, even where permissible, is not favored, except upon the clearest mandate. It is the normal and usual function of legislation to discriminate between closed transactions and future ones or others pending but not completed. The discrimination which the Government fears will follow from acceptance of the taxpayer's view admittedly will result. But it is one consistent with the normal consequences of legislation in the drawing of a line between the past or the present and the future. It also was one necessary for Congress to make if it were not to make another or others equally bad or worse. The Government's concern in this case is not that the taxpayer will suffer harsher discrimination under petitioner's construction than under its own. It is rather that he will not suffer it. For, as interpreted by the Government,[36] Sections 268, 270 and 276(c)(3) applied in conjunction would be much more likely to produce new, and retroactive, tax burdens than tax benefits. The present case is an illustration. To this the Government might be entitled if the statutory mandate were clear. It cannot have that advantage by dubious construction which ignores so much of the statute's setting, purpose and history. The letter does not require this. The consequences forbid it.

There remains for consideration the refusal of the Court of Appeals to reverse the findings of the Tax Court as to the original cost of the apartment building and the propriety of deductions claimed in 1937 for decorating expenses.[37] The Tax Court, in arriving at the cost of the building, refused to allow an alleged ten per cent contractor's commission paid to the debtor company's principal promoter and original sole shareholder because it was not convinced by petitioner's witness "that any amount was actually paid by the old company for contractor's services.

[36] That is, with Section 270 as operating independently of Section 268, to require reduction in basis even though no actual tax benefit has been derived under 268.

[37] Cf. text at note 8 *supra*.

1 T. C. 163, 175. The Tax Court also concluded, after hearing vague testimony on two small deductions in 1937 for decorating and repairs, that these were not properly taken, because the same deductions for the same purposes had been claimed and allowed in 1936. These issues were well within the principle of the *Dobson* case. The Tax Court was upheld in these respects by the Court of Appeals and we accept these findings.

Accordingly, the judgments are reversed and the causes are remanded to the Circuit Court of Appeals for further proceedings in conformity with this opinion.

Reversed and remanded.